accelerating technological change. Additionally, the parties claiming a lack of competition fail to acknowledge what the Commission recognizes, "price alone is not the only measure of effective competition. Effective competition can also be provided by carriers which offer superior service." D.93-02-010 (mimeo) at 43. These parties similarly fail to recognize that "customer satisfaction is an important measure of the success of competition." 24 CPUC 2d at 565. Both the FCC[12] and this Commission have concluded that cellular carriers compete effectively on the basis of service quality. "The incentive for such willingness is the carriers' desire to keep the customer from switching to a competitor." D.90-06-025 at 22. (Emphasis added.)

AirTouch Communications is prepared to demonstrate at hearings that, in addition to a decline in prices, cellular customers have benefitted from enhanced service quality and an expanding variety of services.[13] Ironically, it is just this competition that the resellers criticize. CRA asserts that

> [a]t best [under the current structure], one duopolist may achieve a temporary advantage by establishing broader coverage or maintaining better quality service. This advantage will be transitory, however, because the other duopolist will match the coverage and service quality characteristics of its competitor in as short a time as possible. CRA at 13.

2. **There is no evidence of anticompetitive behavior.**

The resellers boldly assert the existence of explicit and implicit collusion among the carriers.[14] The only "evidence" of alleged collusion is the mere fact that carriers' prices are similar. However, the Commission has recognized that "[i]n a fully competitive market, the

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12 Cellular Auxiliary Service Offerings, 3 FCCR 7033, 7038 (1988).

13 PacTel at 17.

14 CRA at 10; CSI at 22.

prices of individual firms track closely and may even be identical." D.90-06-025 at 49. Indeed, the County of Los Angeles argues that similarity of prices is not due to collusion, but rather is the anticipated "legal" response to the duopoly market structure.[15] There is no evidence to support a claim of collusion under the existing market structure and it certainly will not be a concern in the new wireless market with as many as nine competitors.[16]

3. Partner-competitor relationships do not limit competition.

CRA also claims that the existence of partner-competitor relationships is a characteristic unique to California that impedes competition. CRA at 3-5. CRA asserts, without support, that cellular carriers are not likely to challenge a competitor that is also a partner. This assertion fails to acknowledge the existing evidence of competition between cellular carriers. See, e.g., CSI at 29-31. Moreover, the Department of Justice, the Federal Communications Commission and this Commission have repeatedly examined such

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15 Opening Comments of the County of Los Angeles ("LA County") at 10, 18.

16 CRA also asserts that bundling of CPE and cellular service may lead to "anticompetitive conduct." CRA at 46. CRA fails to recognize, as commented upon by Dr. Hausman in the context of the interexchange market, that price cap regulation, not bundling, leads to anticompetitive behavior. Cellular carriers are not currently regulated under price caps and do not have the incentive to abuse the practice of bundling. In an environment free of rate regulation, bundling encourages competition through increased subscriber growth and output. AirTouch Communications understands that this issue will be dealt with in greater detail in response to the Petition of Bakersfield Cellular Telephone Company for Modification of D.89-07-019 and Ordering Paragraph No. 16 of D.90-06-025, dated July 9, 1993, in I.88-11-040.

relationships, yet they have never concluded that such arrangements lessen competition.[17]

4. The Commission cannot act upon unsupported allegations of "monopoly rents".

Certain parties [18] assert that the "monopoly rents" received by the cellular carriers are indicative of a lack of competition. This contention is both theoretically and quantitatively faulty and conflicts with the Commission's prior findings rendered after examination of the industry. First, the Commission has repeatedly recognized that earnings are not an accurate measurement of competition. As the Commission observed, "[r]ates of return vary for many reasons and do not per se indicate the absence of effective competition. D.93-02-010 at 49; see also 24 CPUC 2d at 559. "Neither pricing patterns nor profits can

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17 See In the Matter of Application of MMM Holdings to Acquire LACTC via LIN, FCC Opinion, 1989 FCC Lexis 2466 (Nov. 6, 1989) (statement of Commissioner Barrett); In re Application No. 89-08-020 of MMM Holdings for Authority to Acquire LACTC via LIN Broadcasting, D.89-12-056, 34 CPUC 2d 198 (1989); In re Application No. 85-08-023 of Pacific Telesis Group to Acquire Control of Communications Industries, D.86-02-059, 20 CPUC 2d 585, 592; In the Matter of Capitalization Plan of Pacific Telesis, FCC Memorandum Opinion and Order, AAD 5-1213, Mimeo No. 2845 (Feb. 27, 1986); In Re Application of James F. Rill and Pacific Telesis for Consent to Transfer Control of Communications Industries, FCC Memorandum Opinion and Order, 60 RR 2d 583, 592 (Step 2); In the Matter of Application No. 87-02-017 of PacTel for Authorization to Acquire/Control BACTC, D.87-09-028, 1987 CPUC LEXIS 197.

18 CRA at 32; CSI at 5; LA County at 27-29. The County of Los Angeles point to the high market values of cellular franchises as evidence of a lack of competition. LA County at 25-27. Opening Comments of Nationwide Cellular Service, Inc. ("Nationwide CSI") at 12-16. Under this theory any successful company which sells stock for an amount greater than its book value is capturing a "monopoly rent," regardless of the scarcity of the commodity involved. The county of Los Angeles attributes the "monopoly rents" to the existence of a "bottleneck." LA County at 37. It should be noted that the market valuations for ESMRs are consistent with values for cellular, given their growth rates and average monthly revenues. See PacTel at 45-46. The ESMR providers, however, do not control a "bottleneck."

indicate directly whether or not cellular carriers are competing fully with each other."[19] D.90-06-025 at 49.

Second, the Commission studied cellular carriers' rates of return, including certain historic rates claimed by the resellers to be excessive, and concluded that "[t]he record [did] not substantiate that cellular carriers are earning an excessive return on their investment." D.90-06-025 at 105 (Conclusion of Law 20). The Commission rejected comparisons of cellular returns-on-investment to the monopoly telecommunications market, noting that the risk is substantially different between the markets and that current earned rates of investment do not in and of themselves directly indicate whether rates are reasonable or unreasonable.

> Unlike a monopoly which is given a fair rate of return commensurate with risk, and the opportunity to attain it, a cellular carrier is not assured any return or recovery of risk. D.90-06-025 at 48.
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> . . . .
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> Absent a risk analysis and a mechanism to measure a reasonable rate of return on cellular investment, there can be no finding that cellular carriers are earning an excessive return on their investment. Id. at 50. See also id. at 99, 101, 105 (Findings of Fact 82-85, 100, 101; Conclusion of Law 20).

Third, the calculations offered by the resellers regarding the alleged rates of return from which they conclude that "monopoly rents" are being earned are based on faulty and incomplete analysis. The calculations are based on a pre-tax calculation which is misleading. Cellular carriers as partners operating cellular franchises incur tax liability. This is a legitimate expense and the returns should include

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19 See also CACD Report on 1991 California Interexchange Market Monitoring Plan, December 1993, at 8 ("[r]evenues are, at best, a precarious measure of growth and/or market share because the profitability of carriers is not standard. The resulting measurements are unstable and not easily comparable.").

a provision for income taxes. Revised returns, reflecting the legitimate tax expense, are significantly lower. In fact, the Los Angeles SMSA Limited Partnership shows a decline for the last three years.

The resellers also assert that the Commission found that 14.75% was a reasonable rate of return for cellular carriers.[20] In fact, in D.93-05-069, the Commission expressly disavowed 14.75% as a relevant rate of return for cellular service: "we do not believe that the record is adequate to support the imposition of cost-based unbundled wholesale rates nor a 14.75% benchmark rate of return."[21] D.93-05-069 at 8. Notwithstanding the lack of evidence to support the 14.75% rate of return, the resellers use it to calculate a "reasonable" pre-tax return. The resellers do not agree, however, on the proper calculation.[22]

Additionally, the resellers use accounting measures, rather than correct economic measures, and thus fail to acknowledge several critical factors in their assessment of returns. For example, their calculations do not account for the significant expenditure in marketing costs required to obtain and retain customers, as well as the impact of

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20 CSI at 6; CRA at 15.

21 This figure was borrowed from a Pacific Bell proceeding. See D.92-10-026 at 25. As noted earlier, the Commission has expressly found that it is not "a valid comparison" to determine price competition between cellular carriers or the reasonableness of rates based on the monopoly telecommunications market. D.90-06-025 (mimeo) at 48.

22 CSI computes a pre-tax rate of return of 18.5%, based on the erroneous assumption that only half of the return is taxable. CSI at 6. In contrast, CRA calculates a 25% rate of return. CRA at 15. It should be noted that resellers' returns have exceeded these numbers. See, e.g., 1992 Annual Report of Comtech Mobile Telephone Company, which calculates out to a post-tax return of 42.1% in 1992; 1991 Annual Report of CSA, which calculates out to a post-tax return of 28.9%.

operating efficiencies, demographics and geography on profitability.[23] Indeed, the wide disparity in returns among the carriers, even as calculated by the resellers, demonstrates that no easy assumptions can be made regarding earnings as a measurement of competition. Assessment of carriers' earnings as an indicator of competition remains problematic due to the rapidly depreciating network infrastructure arising from the conversion to digital, as well as the inherent problems in valuing spectrum.

Finally, consistent with sound economic theory the Commission has recognized that in a duopoly, firms may properly earn "duopoly rents" despite intense competition.[24] Accordingly, the Commission has determined that for substantial efficiency and cost reasons, "it is

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23 Similarly, the "Q" ratio analysis presented by Nationwide Cellular ("Nationwide") is not well founded. Based on the Hazlett study, Nationwide claims that the cellular industry has extremely high Q ratios reflecting not the value of the operating systems, but rather the FCC licenses. The Q value is based on the replacement costs of assets, but Professor Hazlett fails to account for important assets relevant to accurate market valuation. For example, his Q valuation fails to account for the high investment costs of obtaining current customers. Indeed, when resellers transfer their business, they sell their customer base for significant sums. The Hazlett study (p. 33) recognizes the intense competition to acquire new customer, but fails to include it in the replacement value of assets factored into the Q value.

The Commission cannot rely upon Professor Hazlett's Q value as an accurate indicator of market power. The Hazlett study asserts that the proper Q ratio in a competitive industry will generally by 1.0. However, the calculation of the approximate Q ratio for Nationwide itself, using an approach similar to Professor Hazlett's, yields a Q value greater than 2.1. According to Professor Hazlett, such a high Q value would demonstrate significant market power, even though Nationwide does not control a "bottleneck." Furthermore, since resellers are free to enter the market, there can be no market power. Thus, Professor Hazlett's approach leads to nonsensical result.

24 "[W]e recognized that profits may be earned by wholesale carriers due to their FCC-granted right to use scarce radio frequencies or spectrum. It is economically efficient and an appropriate spur to system and service expansion for wholesale carriers to keep those profits." D.90-06-025 at 59.

proper public policy to forbear from rate of return or profit based regulation of cellular carriers that are pricing their services competitively."[25] Nothing has changed to undercut the wisdom of the Commission's prior forbearance. There has been no risk analysis or mechanism developed in this proceeding to measure a "reasonable return" upon which to base a contrary conclusion. Indeed, the factual predicate for any concern about "rents"--the existence of an FCC mandated duopoly--is now only of historical interest. Competition, not regulation, has and will continue to efficiently eliminate market power "rents."

B. **The Commission cannot accept obsolete definitions of the relevant market or the appropriate measurements for competition.**

Certain parties maintain that the lack of competition between carriers stems from the inability of new entrants to challenge cellular carriers' alleged "hold" on the market.[26] As demonstrated above, it would be foolhardy to simply accept these allegations of a lack of competition in light of the evidence to the contrary and faulty assumptions. Moreover, as new service providers rush to enter the market and technological innovation expands the ability of existing alternative technologies to compete with cellular service, any concern regarding a "hold" on the market is unfounded. Additionally, the alliances in the market that the resellers identify as inhibiting competition continue to change.[27] For example, CRA points to the

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25 Id. at 60.

26 CRA at 12; CSI at 19, 22; LA County at 18-25.

27 CRA at 3-5; CSI at 29.

affiliation between cellular carriers and former Bell system companies and GTE. CRA at 3. These alliances are shifting and restructuring the market. On April 1, 1994, AirTouch Communications will become an independent wireless service provider. Conversely, new market entrants are aligning themselves with telecommunications giants, as evidenced by MCI's recent investment in excess of $1 billion in Nextel.[28]

Clearly, assumptions regarding the past market structure are simply irrelevant and cannot predict the future. If a regulatory framework based on such assumptions is established, it will be rendered obsolete by new market conditions. Accordingly, the Commission must assess existing conditions, define the relevant market and determine the appropriate measurements for actual and potential competition prior to establishing a regulatory framework. Such an approach would be consistent with the Commission's recognition of the need for a "forward looking" regulatory strategy: "We intend to promulgate a flexible and forward-looking regulatory framework that will meet customer needs while accommodating some of the changes that appear likely in the near future." D.90-06-025 at 5; see also D.93-09-076.

1. **The parties dispute the definition of the relevant market.**

Definition of the relevant market is a critical first step to determine whether a competitor has market power. 24 CPUC 2d at 555. The Commission cannot identify a "dominant" carrier in a vacuum; it must be placed in the context of the market. AirTouch Communications submits that the proper market includes all forms of wireless communications.[29]

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28 "MCI to Acquire 17% of Nextel, a Cellular Firm," Wall Street Journal, March 1, 1994, at A3.

29 See also BACTC at 22-23; Fresno at 13-14; GTEM at 8-10; LACTC, Exh. A at 5; McCaw at 20-23. Other parties have limited their market (continued...)

Evidence submitted at hearings would demonstrate that continuing changes in technology and market structure will allow cellular, enhanced specialized mobile radio ("ESMR"), personal communications systems ("PCS"), mobile data, paging and mobile satellite services to compete with one another. The market will continue to expand as new generations of computer products with mobile functionality reshape the marketplace. The inclusion of all wireless service providers is consistent with the OII's recognition that "cellular is but one method for delivering mobile services." OII at 8, 17-18.

Prior to establishing a regulatory framework the Commission must define the market through an examination of the underlying economics. An unduly narrow definition of the market based on mere assumptions regarding these services would produce misleading information and require restructuring of the regulatory framework before it can even be implemented.

2. **The Commission must identify the appropriate measurements for competition prior to implementing a regulatory framework.**

The parties are in dispute as to the relevant measurements for competition in the wireless market. This conflict is not surprising because, as the Commission has recognized:

> no one measure or benchmark will prove whether a market is effectively competitive or not. . . . "In order to judge market performance, you have to look at a lot of things" (citation omitted). One should not look at a piece of data in isolation. D.93-02-010 at 29-30.

29(...continued)
analysis to cellular, ESMR and PCS providers. CRA at 17-24; DRA at 6-10; Pacific Bell at 31-32; MCI at 9-11; CCAC at 32-33.

Clearly, a regulatory framework cannot be established based on unsupported assertions regarding a single measure of competition such as price.

AirTouch Communications has recommended that the Commission examine the benchmarks of competition utilized in the interexchange market as a starting point.[30] These benchmarks include the capabilities of market competitors, access or technical constraints of the market, competitors' market shares, the ease of market entry or exit, trends in carriers earnings and service quality and price competition. See 24 CPUC 2d at 546. DRA similarly notes that data relating to some or all of these factors should be analyzed to determine the level of competition in the industry and that the relative weight of each factor should be determined. DRA at 18. DRA asserts that analysis of the appropriate factors should be undertaken after a regulatory framework is established. Ibid. Such an approach would be shortsighted. The establishment and analysis of the appropriate measurements of competition will clarify the level of actual and potential competition in the wireless market. This analysis is critical to defining the level of regulation best suited to enhance competition.

C. The parties dispute the ability of the new entrants such as ESMRs and PCS to compete with cellular carriers.

The parties have presented conflicting positions regarding the new competitors entry into the market, costs, technical capability and pricing schemes, among other factors. These matters require the

30 PacTel at 26. U S WEST also identified the benchmarks utilized in the interexchange market, as well as technological advancement. U S WEST at 10.

submission of factual and economic analysis which cannot be resolved through a review of the parties' comments.

In analyzing the concerns regarding the ability of the new competitors to enter the market, the Commission must recognize that Nextel has already entered the market.[31] Similarly, there is no reason why PCS providers will not be able to enter easily and compete successfully, as evidenced by the performance of PCS in the United Kingdom. Parties' claims regarding cellular's "headstart" and name recognition are undercut by past experience. The Block A carriers had no trouble capturing market share upon entering the cellular market. As to name recognition, Nextel is simply in the same position as AirTouch Communications. Additionally, ESMR and PCS providers will face no barriers to expansion. As the majority of the parties have concluded, spectrum is no longer a supply constraint. Thus, these alternative service providers will be able to supply sufficient output to defeat any attempted price increase by a cellular carrier.

The resellers assert that ESMRs' costs will "probably" be higher because their systems are new. CRA at 17. This assumption does not consider the fact that ESMRs such as Nextel may build from the ground up and thus avoid digital conversion costs, and that ESMRs can further reduce costs through the benefit of actual empirical information regarding capacity and traffic learned from the cellular carriers' experience. This claim is also difficult to reconcile with the fact that Nextel is using the identical digital technology, TDMA, that some cellular carriers are implementing.

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31 Nextel at 14.

The resellers also claim, without support, that even if ESMRs' costs are the same as cellular, Nextel will follow cellular's lead in setting prices. They base this claim on the experience in a totally different industry, the interexchange market. CRA at 18. This claim is contrary to Nextel's stated position[32] and wireless market experience. Nextel's entry was a significant contributor to the decline of prices in the Los Angeles market by 17 to 22%. This level of price competition has not been evident in the interexchange market.

DRA claims that Nextel will operate in a niche rather than compete head to head with cellular. DRA at 9-10. Again, this claim is unsupported and directly contrary to Nextel's stated intent. As Nextel asserts, it "fully expects to compete vigorously for as much of the wireless market as it can possibly gain."[33]

These alleged deficiencies of ESMRs must be balanced against ESMRs' numerous advantages over cellular: simpler upgrades due to a uniform platform, multiple services available on one unit, ESMRs historic position in the market facilitating volume sales and a nationwide network allowing lower priced roaming. Certainly, the investment community has not been deterred by any deficiencies in ESMRs, as evidenced by MCI's recent significant acquisition of Nextel's stock.

The resellers and DRA similarly attempt to undercut PCS as viable competition to cellular carriers. They argue that PCS will be delayed for five years during licensing, manufacturing and construction.[34] In contrast, another party asserts that PCS will be offering a competitive

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32 Nextel at 12-13.

33 Id. at 22.

34 CRA at 21; DRA at 6.

service as early as the end of this year.[35] If the Commission merely assumes that PCS will be substantially delayed, it may well make the mistake of adopting a regulatory framework that must be restructured before it can even be implemented.

The resellers also claim that PCS faces technical hurdles and that only cellular carriers have "ready to use" networks. These assumptions are undercut by the evidence of successful PCS operation in the United Kingdom, where the PCS network was built from scratch, as well as trials in the United States. Concerns regarding technical constraints have not deterred local exchange carriers, long distance carriers and cable companies from their pursuit of PCS licenses. The resellers also fail to recognize that Cox Communications has been granted a Pioneer's Preference and has an existing infrastructure that will vastly reduce both the cost and time necessary to construct a network in California.[36]

Based on the conflicting claims regarding the capabilities of the new market entrants, there is no clear evidence upon which the Commission can rely to set up a framework handicapping select competitors. At a minimum, the dispute regarding the level of competition offered by ESMR and PCS providers is a question of fact that must be resolved through an evidentiary hearing.

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35 Fresno at 29.

36 Indeed, if the resellers are correct in their theory of "monopoly profits," the PCS providers have the economic incentive to construct their systems as quickly as possible.

D. There is no record upon which to establish an appropriate indicator of market share for "dominant" status.

The Commission cannot proceed with the OII's proposed framework without evidence of the proper basis for determining dominant status. The parties' comments reflect a wide disparity in views regarding the use of market share to determine dominance, as well as the appropriate measurement for market share. This conflict is not surprising since, as the Commission has observed: "[t]here are potential problems with use and measurement of market share which must be guarded against. One problem is that current market share within the telecommunications arena is a static measure in what is a very dynamic industry" (emphasis added) 24 CPUC 2d at 557.

In light of the inherent problems in the use and measurement of market share, the Commission should receive further evidence on this issue. The wide variety of indicators identified by the parties illustrates the need of further examination. Parties have commented that market share can be measured by: minutes of use, capacity based on bandwidth and the type of technology (digital or analog), available spectrum, traffic on any function of a cellular network within a given market, subscribers, population coverage, wholesale revenues, number of mobile units, conversion minutes and industry revenues. Obviously, since there is a dispute over the proper measurement of dominance, the parties also dispute the identity of competitors to be treated as dominant.[37] Parties advocating that cellular carriers be treated as "dominant" base this claim on the assumption that cellular carriers will

37 For example, CSI argues that affiliates of local exchange carriers should not be entitled to enter any market as a nondominant provider. CSI at 26. Conversely, Pacific Bell and Citizens argue that their PCS affiliates will be nondominant. Citizens at 2, 4; Pacific Bell at 5-6.

have market power in the new wireless market. There has been no evidence introduced to support this assumption. Each cellular carrier currently has less than 50% of the cellular market. Thus, it can hardly be assumed that after the entrance of ESMRs and PCS cellular carriers should be treated as dominant. The Commission should explore through hearings and/or workshops whether use of market share is relevant in the wireless market and, if appropriate, the relevant measurements of market share.

E. The Commission cannot ignore the detrimental impact that disparate regulatory treatment will have on wireless service providers.

The cellular carriers have identified several aspects of dominant/nondominant regulation that will undermine competition in the wireless market. Given the grave consequences that will result from disparate regulatory treatment of cellular service providers, the Commission must explore the matter further.

As a threshold matter, the Commission should pause prior to implementing a regulatory framework that is at odds with the intent of Congress and the FCC that regulatory parity be given to wireless service providers offering functionally equivalent service. The Commission should also explore whether such disparate regulatory treatment is consistent with its stated goal to avoid "maintaining preferred market positions through regulation," which ultimately harms consumers. See D.90-06-025 at 17.

Most importantly, the Commission cannot afford to ignore the likely outcome of disparate regulatory treatment identified by parties in this proceeding. Competition will be reduced because cellular carriers will be unable to meet or beat the price reductions and innovative marketing

packages offered by ESMR and PCS providers. In addition, development of the national and international "superhighway" will be inhibited as dominant regulation strips cellular carriers of the incentives, relative to those of their competitors, to develop technological innovations to meet capacity demands and improve service. Such a result would be directly contrary to the goals stated in the Commission's Report to the Governor, as well as its goal to encourage technological innovation. See Report to the Governor ("Rept. to Gov.") at vii-viii, 7-8; D.90-06-025, 7-8, 93-94 (Findings of Fact 14, 17-20). The question must be asked: Can California afford to place these goals at risk without even examining, through evidentiary hearings, the potential impact of dominant/nondominant regulation?

V. UNBUNDLING IS BEYOND THE COMMISSION'S AUTHORITY AND IS ECONOMICALLY AND TECHNICALLY UNSOUND.

The Commission should cautiously evaluate the OII's unbundling proposal. First and foremost, the Commission does not have the authority to implement unbundling in light of FCC preemption and the potential conflicts with federal standards. Indeed, even if the Commission had such authority, the proposal is economically inefficient and technically infeasible. Moreover, the very practicality of the proposal must be questioned since, by the time unbundling can be implemented, the wireless marketplace will be a multicompetitor environment, thus eliminating the alleged excuse for unbundling.

A. The Commission does not have the authority to order unbundling.

Unbundling, as described in the OII and by several parties, clearly constitutes rate regulation since it would require cellular carriers to define and implement rates applicable to the various unbundled

components. These rates do not exist today. There can be no doubt that both cost-based price caps and price caps at existing rates would constitute rate regulation under Section 332 of the Communications Act. 47 U.S.C. § 332.

The Commission does not have the authority to impose any of these components of the OII proposal at the present time and may not have such authority until August 10, 1995, assuming the FCC exhausts the time frame within which it must act on the Commission's petition. Thereafter, such regulation can only be imposed if the FCC grants the Commission's petition without conditions prohibiting such regulation. At that time, it is probable that Nextel will have expanded service throughout California and Cox Communications, or another PCS provider, will be in operation.

Even if the Commission had the authority to proceed with unbundling at this juncture, the proposal would still be prohibited because it conflicts with federal standards. The FCC has asserted federal primacy over technical standards and the competitive market structure for cellular service. Unbundling will allow cellular resellers, who are not licensed by the FCC, to exercise control over the cellular spectrum. The unbundling proposal would undermine the FCC's carefully thought out cellular scheme and cannot be undertaken without the FCC's approval. In addition, to the extent that unbundling impacts interstate calls, the proposal may conflict with the federal scheme. Interstate cellular calls fall within the FCC's exclusive jurisdiction pursuant to section 2(a) of the Communications Act of 1934. 47 U.S.C. § 152(a). The Commission lacks the authority to require the carriers to interconnect with the resellers' switches without consideration of the FCC's standards and policies regarding such interconnection. The

Commission cannot proceed with any unbundling proposal that would conflict with or undermine federal standards.

B. Unbundling will create rather than solve problems.

The parties are in sharp disagreement as to whether the wholesale tariff should be, or even can be, unbundled. Even the parties who support unbundling are divided as to how it can be accomplished. There is no evidence that unbundling is necessary, feasible or desirable, especially with the rapid changes in the wireless marketplace.

1. The alleged basis for unbundling, a bottleneck monopoly, does not exist.

Both the OII and certain parties claim that cellular service is a bottleneck. However, the proponents of unbundling cannot even agree regarding the location of the alleged bottleneck.[38] The Commission should require proof that a bottleneck exists prior to proceeding with the OII's plan.[39] Claims that cellular service constitutes a "bottleneck facility" are contrary to both the legal and economic definition of a true "bottleneck." There is no evidence of control of any essential facility. In fact, the Commission has expressly found

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38 The County of Los Angeles claims the bottleneck is located at the two way radio links. LA County at 16. CRA asserts that the "'bottleneck' may extend to tower access, cell sites and switch facilities." CRA at 24. Additionally, the resellers seek a guaranteed interconnection to PCS networks as well as cellular, yet they have provided no evidence that seven PCS providers will constitute a bottleneck. See CRA at 16.

39 CRA maintains that carriers have violated Public Utilities Code § 532 by denying resellers cost-based interconnection for enhanced services while offering such interconnection to the United Parcel Service ("UPS"). CRA at 45-46. CRA fails to acknowledge, however, that the service offered to UPS is an enhanced interstate service regulated by the FCC. As an enhanced interstate service, it is not subject to Commission tariff regulation. PacTel Cellular has not discriminated against the resellers, or any other entity, in offering tariffed services.

that "there is no bottleneck monopoly . . . . Unlike monopoly local exchange telephone companies, cellular carriers have no captive market of monopoly ratepayers." D.90-06-025 at 59, 100 (Finding of Fact 87); see also id. at 99 (Finding of Fact 82). If there was no "bottleneck" in 1990, it cannot exist now. Cellular carriers have competed for over ten years, offering customers a choice of service, quality and price for a discretionary service. As Nextel states, "No customer is forced to use its service". Nextel at 13.

Moreover, even the OII recognizes that there is an issue as to "whether unbundling requirements are needed in a competitive market." OII at 27. ESMRs and PCS are entering the market, thus eliminating the alleged excuse for unbundling. Nextel observes that the FCC has allocated sufficient spectrum that the underlying rationale for unbundling no longer exists: "Supply has been increased directly without artificial means. Thus, if the Commission 'expects the market to be competitive in the future,' unbundling requirements are unnecessary (citation omitted)."[40]

CRA and CSI have suggested that the ONA rulemaking proceeding can be used as a template for unbundling in the wireless context.[41] The Commission should hesitate prior to launching into a lengthy proceeding based on the policies and procedures articulated in the ONA rulemaking. The Commission's rules in that proceeding parallel those of the FCC in its ONA proceeding, CC Docket Nos. 89-79, 88-2 and 92-91 and its switched interconnection proceeding, CC Docket No. 91-213. The FCC developed its rules based on a lengthy record analyzing interconnection

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40 Nextel at 19; see also Pacific Bell at 21.

41 CRA at 41; CSI at 14.

in the wireline context. See R.93-04-003. There has been no evidence presented in the FCC proceedings or the ONA rulemaking that the wireline context is comparable to the dynamic wireless environment. In fact, the Commission expressly refrained from imposing open access obligations on cellular carriers in that proceeding.[42] Moreover, the ONA rulemaking proceeding contemplates evaluation of incremental, fully allocated and direct embedded cost studies in different circumstances. R.93-04-003 at 65-66. By the time such studies would be completed in the wireless context, the new market entrants will have long since arrived, thus obviating the alleged need for unbundling altogether.

2. Unbundling is not cost effective.

The Commission has expressly indicated that it would hear evidence on the economic feasibility of unbundling and the reseller switch.[43] Rehearing on this issue is particularly crucial since claims that unbundling will lead to operating efficiencies resulting in cost reductions are unfounded. Unbundling would lead to an increase in the costs of providing cellular service since the reseller switch would merely duplicate the carriers' MTSOs functions.[44] This can only result in a loss of economic efficiency and higher prices for consumers since cellular carriers' costs, other than LEC interconnection costs, will not decrease because the costs of servicing the reseller switch will be

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42 R.93-04-003 (mimeo) at 35.

43 "[B]ecause the economic feasibility of the reseller switch is dependent on unbundling of the wholesale rates, we will grant rehearing on the reseller switch concept so that we may consider these issues together." D.93-05-069 at 8.

44 Exh. W9 (Chessher Testimony) in I.88-11-040 at 7; Exh. W14 (McNeely Testimony) in I.88-11-040 at 2.

higher. Accordingly, the Commission should proceed with rehearing on the issue of the economic feasibility of the reseller switch.

3. Unbundling will not benefit consumers.

Resellers and retailers already have access to customers and operate in a competitive market. There has been no evidence presented to demonstrate that unbundling will provide consumers with greater choice. The reseller switch would merely mimic cellular carrier landline functions rather than add any new service.[45]

Moreover, the resellers maintain that unbundling requires cost-based rate of return regulation. In other words, absent a regulatory imposed subsidy of inefficient competitors, the proposal has no merit. This should be a red flag to the Commission, especially since cost-based regulation will have serious negative efficiency consequences for the wireless market and cellular consumers.[46] If unbundling is imposed, cellular service will become less competitive because of an uneconomic added layer of costs created by a reseller switch and imposed on select competitors. The proposal can only undermine cellular carriers' incentives to continue investing in infrastructure development and capacity expansion.

4. Unbundling is not technically feasible.

Numerous parties have pointed out that the OII's unbundling proposal simply will not work with existing analog technology.[47] The Commission cannot ignore these potential problems. It cannot simply be assumed, as

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45 Exh. W11 (Hausman Testimony) in I.88-11-040 at 14; Exh. 19 (Nelson Testimony) in I.88-11-040 at 14.

46 PacTel at 58-63.

47 PacTel at 70; U S WEST at 43-45; LACTC at 30-31; GTEM at 41-42; McCaw at 30-34.

advocated by CRA and CSI,[48] that unbundling in the wireless context is identical to the landline context. Even service providers that would not be subject to unbundling recognize that it creates technical problems.[49] As Nextel states, the proposal

> rests on several misconceptions regarding the operation of wireless networks which involve highly sophisticated management of radio signals and frequency reuse techniques in strategically located cells and microcells to permit numerous mobile radios to use the same frequency simultaneously. . . The Commission should not adopt any proposal for "unbundling radio links" without first holding hearings at which the alleged feasibility of this idea could be fully aired and tested. Nextel at 19-20.

In view of the conflicting views of the parties and the numerous disputed issues, it would be foolhardy to order unbundling at this juncture. Indeed, it is doubtful that the Commission even has the authority to implement unbundling. If the Commission is, nevertheless, inclined to proceed, then at the very least, full evidentiary hearings must be held.

VI. THE PARTIES DISPUTE THE NEED FOR, MUCH LESS THE FORM, OF RATE REGULATION.

The parties have advocated every form of regulation raised in the OII, and then some. Even the parties who support the concept of unbundling do not agree as to how it can be achieved. The parties dispute:

- the necessity for and form of rate regulation to accompany unbundling;
- the appropriate price indices;
- the application of a "Z" factor;
- the application of an initial weighted price cap;
- the necessity for valuing spectrum;
- the application of a productivity offset; and
- the process to implement the regulation.

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48 CRA at 2; CSI at 14.

49 Nextel at 18.

Resolving these issues will be, as Nextel observes, "a prescription for quagmire and gridlock,"[50] as the Commission lacks the necessary resources for conducting major rate cases for cellular. Indeed, "cost allocation issues could make [the IRD] look like a picnic." Ibid. (fn 22).

With this divergence in views and the Commission's prior findings that market forces should set prices for cellular service, the Commission cannot simply assume that regulation more restrictive than current regulation is appropriate. California cannot afford the impact of rate regulation which will inevitably stifle both competition and innovation.

A. The Commission has previously rejected cost-based/rate of return regulation for cellular service.

Several parties have argued that unbundling can only be effective if cellular carriers are required to price the components of their wholesale service at direct embedded cost plus a rate return.[51] These parties do not agree however, regarding the implementation of such regulation.[52] CRA and CSI would impose a 14.75% rate of return

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50 Nextel at 21.

51 CRA also argues that the Uniform System of Accounts ("USOA") initially adopted in D.92-10-026 is a "prerequisite for cost-based pricing" and should be adopted. CRA at 38. The USOA cannot simply be adopted. The parties have the right to rehearing on this issue. In D.93-05-069, the Commission stated that: "the parties will have the opportunity to be heard on the question of whether the potential for cross-subsidization will continue to be a problem, and on the best method for controlling it. . ." (emphasis added) D.93-05-069 at 6.

52 CRA proposes cost-based unbundling based on direct embedded costs (pending the implementation of which the carriers should unbundle their existing market-based rates to resellers), together with cost-based interconnection rights. CRA at 7. CRA requests lengthy proceedings involving a market by market approach. As a threshold matter, CRA's proposal is based on unproven assumptions regarding cellular carriers

(continued...)

borrowed from a Pacific Bell proceeding.[53] While these parties attempt to avoid the label "rate of return," this is exactly the form of rate regulation that was directly and expressly rejected by the Commission in D.90-06-025.

The Commission extensively examined a variety of regulatory options in I.88-11-040 and concluded that rate of return regulation would be neither efficient nor workable for cellular carriers.[54] The record was replete with evidence on the economic and regulatory problems with rate of return regulation.[55] In its decision, the Commission commented at

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52(...continued)
ability to exert pricing power. Secondly, CRA's approach would require "studies and reports that identify the costs of each of the separate components of the tariff services." Id. at 28. As observed in the OII and by other parties, the pace at which this form of cost-based regulation can be implemented will be outstripped by the pace of market change.

MCI supports the unbundling of "core radio functions," together with the imposition of cost-based price caps (MCI at 12, 15), but feels that "unbundling of core cellular radio functions for reasonable access by competitors of cellular duopoly providers, absent careful attention to landline LEC-MTS provider interconnection arrangements, will do little to spur rapid development of alternative MTS offerings." Id. at 18.

The County of Los Angeles recommends that all unbundled essential facilities be priced on a cost-of-service basis, initially under a rate of return regulation and later under a price cap scheme. LA County at 34.

53 Similarly, CRA would arbitrarily apply price indices and the "Z" factors determined for local exchange carriers to their wireless affiliates. For those cellular carriers unaffiliated with a LEC, CRA would impose a "composite" of the Pacific Bell and GTE measures. CRA at 37. There is no showing that these figures have any relevance in the wireless marketplace. The resellers advocate these arbitrary assignments in the name of "simplicity". CSI at 27.

54 D.90-06-025 at 15-18, 48-50, 59-60, 93-94, 100, 105 (Findings of Fact 14, 90-91, 98; Conclusions of Law 20-21).

55 Ibid. See also Proposed Decision of ALJ Galvin dated June 12, 1992 in I.88-11-040 at 8, 23-24, 40, 42 (Findings of Fact 3, 30); Exh. W11 (Hausman) at 12 (fn 9), 15-17; Exh. E (King) at 11; Exh. O (Hausman) at (continued...)

length regarding the unsuitability of cost-based/rate of return regulation for cellular service, specifically noting that such regulation:

- is inconsistent with the most important regulatory goals of promoting technological advancement, the expansion of service, and economic efficiency;[56]
- will produce different prices for the two carriers' systems causing the higher-priced carrier to lose customers;[57] and
- will cause one system to become overburdened with subscribers, resulting in degradation of service quality.[58]

The Commission concluded that "rate of return regulation would be neither efficient nor workable for cellular carriers." The Commission thus selected the combination of increased pricing flexibility for carriers and Commission oversight of cellular system expansion and utilization to produce just and reasonable wholesale rates through "the competitive process."[59]

There has been no evidence presented in this investigation to demonstrate that a change should be made to the Commission's prior conclusion that a rate of return regulation is inappropriate for cellular. Moreover, there has been no evaluation of the potential economic penalties of such regulation and its impact in light of the entrance of multiple new competitors.

55(...continued)
10, 15 (fn 11); Kumra (DRA) Tr., pp. 280-281; Hausman (PacTel) Tr., pp. 1220, 1224, 1281-1282, 1317-1318.

56 D.90-06-025, p. 100 (Finding of Fact 90).

57 Id. at 16.

58 Ibid.

59 Id. at 101 (Finding of Fact 102) (emphasis added).